Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Developing a Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	

REPLY COMMENTS OF AT&T CORP.

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Pursuant to the Commission's Notice of Proposed Rulemaking ("*Notice*")[1] and Section 1.415 of its rules, 47 C.F.R. § 1.415, AT&T Corp. submits these reply comments on the Commission's proposed modification of existing intercarrier compensation regimes.

INTRODUCTION AND SUMMARY

The comments unsurprisingly confirm the urgent need for reform of the existing patchwork of intercarrier compensation rules. The current rules make distinctions based on artificial regulatory classifications with no economic or engineering significance. "Local" traffic is subject to the efficient, cost-based, calling party's network pays ("CPNP") rule of Section 251(b)(5) – unless the traffic is out of balance (*i.e.*, when efficient intercarrier compensation prices really matter), in which case the arbitrary rate caps adopted in the *ISP Remand Order*[2] apply. Interexchange traffic, both interstate and intrastate, is subject to completely different,

[1] *Developing a Unified Intercarrier Compensation Regime*, Notice of Proposed Rulemaking, 16 FCC Rcd. 9610 (2001) ("*Notice*").

[2] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Order on Remand, 16 FCC Rcd. 9151, ¶¶ 78, 84 (2001) ("*ISP Remand Order*").

and, often, unprincipled, compensation schemes. Treating identical uses of the network in such radically different ways greatly harms consumers and competition. *See infra* Part I.

But the piecemeal reform proposed in the *Notice* could only make matters worse. Compensation that incumbent local exchange carriers ("ILECs") pay to competitive local exchange carriers ("CLECs") would be largely eliminated while the existing access charge regime – which harbors by far the greatest inefficiencies and therefore does the most harm to consumers and competition – would remain in place indefinitely. This selective application of bill and keep ("B&K") has no principled support, and is rejected by the architect of the leading B&K proposal. Implementing B&K for only internet service providers ("ISPs") and "local" traffic would not only leave unaddressed the most important anomalies in the current system, but would, as Dr. DeGraba demonstrates, create dangerous new avenues for anticompetitive conduct.

The answer is not, as some claim, to adopt B&K across-the-board. Rather, the comments confirm that only across-the-board application of cost-based intercarrier compensation under the established CPNP convention will well serve the twin goals of efficiency and competitive neutrality. Cost-based rates replicate the workings of a competitive market and provide efficient incentives to both carriers and consumers. For example, CPNP, to the best extent possible, permits internalization of both positive and negative externalities associated with telephone calls. In the case of unwanted calls, cost-based CPNP requires the calling party to internalize a greater portion of the costs caused by the call, which reduces incentives to make unwanted calls. CPNP is also sufficiently flexible to allow called and calling parties to align the costs and benefits of mutually beneficial calls. *See infra* Part II.

Predictably, the regional Bell Operating Companies ("RBOCs") disagree. But they make only a token effort to address the principal issue raised by the *Notice* – *i.e.*, whether the choice of

B&K or cost-based CPNP would better promote efficient network usage and competitive neutrality. That is because B&K is patently inferior to cost-based CPNP. As numerous commenters demonstrate, B&K would both encourage more unwanted calls (by requiring recipients to pay for a portion of those calls) and weaken consumers' ability to apportion the costs of mutually beneficial calls. B&K is equally, if not more, "regulatory" – because ILECs will retain market power over consumers for the foreseeable future, regulation of the end user charges would be required under B&K and would likely prove *more* difficult than regulating intercarrier charges. In addition, application of B&K would further cede to the monopoly ILECs control over the quality of interexchange calls. Worse yet, as the comments (and Dr. DeGraba's declaration) confirm, B&K would create *new* opportunities for both regulatory arbitrage and monopoly abuse. *See infra* Part III.

In all events, there is no real choice at all. An across-the-board, cost-based CPNP rule would be lawful, while an across-the-board B&K rule would not. The RBOCs' contrary arguments collide with the plain text of the Communications Act ("the Act"). Section 251(b)(5) mandates "reciprocal compensation" for the "transport and termination" of "telecommunications." 47 U.S.C. § 251(b)(5). Sections 251(b)(5) and 252(d)(2) mandate that such arrangements must "provide for the mutual and reciprocal recovery by each carrier" of "costs associated with the transport and termination" of calls that originate on the network of the other carrier. *Id.* §§ 251(b)(5), 252(d)(2)(A)(i). The Commission, citing this plain language, properly concluded in 1996 that B&K may be required for traffic subject to Section 251(b)(5) only where "traffic is roughly balanced."[3] And these requirements cannot be evaded through

[3] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, First Report & Order, 11 FCC Rcd. 15499, ¶¶ 1112, 1113 (1996) ("*Local Competition Order*").

statutory forbearance because the required preconditions to forbearance plainly have not been satisfied. *See infra* Part IV.

Believing that they have already convinced the Commission to zero out the payments they make to fledgling new entrants, the RBOCs instead devote their energy to formulating a series of proposals, largely unrelated to unified intercarrier compensation, that, if accepted, would tilt the competitive playing field even more sharply in their favor. SBC, for example, seeks "pricing flexibility" to raise retail rates based on trumped-up claims of universal service shortfalls. The Commission, however, has properly determined in the *CALLS Order*[4] that it has already removed universal service subsidies from RBOC access charges. But even if reducing access charges to cost would require some increases to end-user rates, those increases should not cause the Commission to delay in establishing cost-based intercarrier rates. *See infra* Part I.

Verizon, seeing UNE-based competition on the verge of collapse, seeks to drive a nail into the coffin of facilities-based competition as well by demanding radical revisions to existing interconnection rules that would force CLECs to mimic ILEC network architectures. Verizon's proposals are unlawful and inefficient. For example, the single point of interconnection ("POI") rule that Verizon urges the Commission to repeal is required by the plain text of the Act and promotes the deployment of alternative facilities by new entrants by allowing them to utilize fully the efficiencies inherent in an efficient "single layer" network architecture in order to reach customers over a diverse geographic region. Verizon likewise seeks only to evade competition and preserve monopoly rents through its proposal to prohibit CLECs from offering "FX"-type services. Those services – and the ability of customers to obtain NXX codes associated with geographic areas other than areas where they are physically located – are particularly important to small businesses, rural Internet users, and wireless carriers. And, contrary to Verizon's claims, CLEC FX services violate no laws, impose no additional costs on incumbents, and *encourage* innovation and efficiency.

ARGUMENT

I. THE COMMENTS OVERWHELMINGLY CONFIRM THE NEED FOR COMPETITIVELY NEUTRAL REFORM OF THE EXISTING PATCHWORK OF INTERCARRIER COMPENSATION RULES.

There is universal agreement that the Commission's current rules treat identical uses of the network very differently based solely on the traffic or carrier involved. "The key problem is that today, payment obligations depend not on what a minute of traffic does to the receiving carrier's network, but on the basis of metaphysical traffic classifications having nothing to do with economics or engineering." Global NAPS at 7. Treating identical uses of the network in radically different ways unquestionably creates uneconomic incentives, opportunities for inefficient regulatory arbitrage, and formidable barriers to competition. *See, e.g.*, Cable & Wireless at 8; Allegiance at 7, 11-12; CompTel at 8. Reform is clearly needed.

As the comments make clear, however, the *worst* thing that the Commission could do would be to adopt the piecemeal implementation of B&K proposed in the *Notice* (¶ 2 & n.2) – *i.e.*, B&K for ISP-bound traffic immediately, B&K for other kinds of traffic years later, if at all.[5] The only dissenters are the ILECs, and their proposals are baldly self-serving. The incumbents

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[4] *Access Charge Reform*, Sixth Report & Order, 15 FCC Rcd. 12962 (2000) ("*CALLS Order*"), *aff'd in part & rev'd in part*, *Texas Office of Public Util. Counsel* v. *FCC*, 265 F.3d 313 (5th Cir. 2001).

propose immediate implementation of B&K for local and ISP-bound traffic (where incumbents pay cost-based charges to other carriers), but indefinite postponement of B&K for other traffic (where other carriers pay exorbitantly above-cost charges to the incumbents). *See, e.g.*, SBC at 2 ("replacing access charges with bill and keep is a much more difficult issue"); Verizon at 18 ("it is far from clear whether the public would benefit from an elimination of the access charge regime"). As the comments demonstrate, such an approach would be profoundly anticompetitive and would leave unaddressed the most pressing problems with the current intercarrier compensation regime.

Dr. DeGraba himself stresses that his B&K proposal could work only as a *unified* proposal applied to all forms of traffic all at once. *See* WorldCom, DeGraba Decl. at 29 ("[t]he COBAK approach is intended to be a unified interconnection regime in which the same rules apply to all traffic, local and toll, as well as Internet"). Implementing B&K only in situations where ILECs make payments to other carriers would simply grant ILECs a massive, unjustified windfall, at a time when the CLEC industry is struggling to survive. *See, e.g.*, Focal at 24-25. From a consumer welfare standpoint, that approach has the priorities exactly backwards. Above-cost access charges, which both directly increase end user rates by billions of dollars annually and create enormous barriers to competitive entry, are by far the greatest intercarrier compensation threat to consumers and competition. *See*, *e.g.*, WorldCom at 10, 17. Because long distance service demand is more price elastic than is local service demand, and because access rates are more in excess of cost than are local reciprocal compensation rates, the

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[5] *See, e.g.*, Ad Hoc at 2, 8-10; AOL at 4; AT&T Wireless at 48; Cbeyond at 7; Focal at 19-25; Global NAPs at 14-21; ITAA at 1, 7-8; Time Warner at 3, WorldCom at 9-13; Z-Tel at 2.

economic welfare damange from the current access regime greatly exceeds whatever may exist in local/ISP intercarrier compensation. And today's bloated access charges also create uneconomic disparities between wireline and wireless carriers.[6] By focusing its attention on ISP-bound traffic to the exclusion of all else, the Commission would truly be engaged in reverse triage.[7]

Moreover, as Dr. DeGraba explains, retaining glaring disparities between local/ISP compensation and above-cost access pricing would not even eliminate any uneconomic incentives and regulatory arbitrage opportunities that currently exist. *See* WorldCom, DeGraba Decl. at 30-31; *see also* Focal at 23; Global NAPs at 11-12. Indeed, piecemeal implementation of B&K, by increasing the disparities in compensation for traffic that is functionally the same, would actually *heighten* the incentives and opportunities for arbitrage. For example, as the Commission found in the *ISP Remand Order* (¶ 90), "[t]he record . . . fails to establish any inherent differences between the costs on any one network of delivering a voice call to a local

[6] For example, the Commission's rules currently exempt CMRS providers from paying access charges on interLATA traffic that both originates and terminates in the same major trading area ("MTA"). Instead, such traffic is subject only to the generally lower reciprocal compensation rates set by the states for transport and termination of local exchange traffic. *See Local Competition Order* ¶ 1036 (deciding that intra-MTA LEC-CMRS traffic is subject to reciprocal compensation, even if the traffic is inter-LATA); 47 C.F.R. §§ 51.701(b)(2), (e); *ISP Remand Order* ¶ 47; *Policy and Rules Concerning the Interstate, Interexchange Marketplace*, Order, 12 FCC Rcd. 15,739, ¶ 15 (1997) (staying application of integration rule "to any separate offering of interstate interexchange service within a major trading area"). Because cellular geographic areas, such as MTAs, are typically larger than LATAs, a wireline call carried by an IXC over LATA lines (but within a given cellular provider's MTA) is burdened with bloated access charges, while a wireless call that likewise crosses LATA lines (but stays within the MTA) is covered by the almost uniformly lower, reciprocal compensation regime. *See, e.g.*, *Policies and Rules Concerning the Interstate Interexchange Marketplace*, 1999 WL 38420 (January 29, 1999) (Powell, Comm'r, dissenting) (noting that "MTAs can include multiple exchanges").

end-user and a data call to an ISP." Because there would be no practical means of distinguishing local and ISP-bound traffic (AOL at 3-4), piecemeal implementation would, therefore, give carriers incentives to try to transform or disguise ISP traffic as traditional local traffic. *See, e.g.,* Time Warner at 20-21; Allegiance at 39-40; Focal at 33 n.60; Global NAPs at 10.

Contrary to the ILECs' claims, across-the-board reform of intercarrier compensation would not undermine universal service. Fumbling for a justification for disparate treatment of access charges, the incumbents claim that (1) any reduction (or, under B&K, elimination) of access charges would deprive the incumbents of subsidies necessary for universal service; (2) retail local rates are not self-sustaining because they are below cost; and (3) therefore, before the Commission can implement B&K for access charges, it must adopt mechanisms designed to force state commissions to raise retail rates. *See* SBC at 2, 31-32; BellSouth at 4 & n.6.

To the contrary, the Commission already has removed implicit universal service subsidies from price cap LECs' interstate access charges in the *CALLS Order*. In that order, the Commission removed $650 million from the price cap LECs' interstate access charges and replaced it with a universal service fund capped at $650 million. *CALLS Order* ¶ 201. As the Commission found, "$650 million is a reasonable estimate of the amount of universal service support that is currently in our interstate access charge regime." *Id.* ¶ 202. Indeed, the Commission noted that "the price cap LECs, who are the largest net recipients of universal service support, have *agreed* that $650 million provides adequate interstate universal service support." *Id.* ¶ 205 (emphasis added). The Commission therefore concluded that a $650 million

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[7] More than one commenter compares such an approach to the joke about changing from driving on the right to driving on the left by using a transition in which only trucks drive on the left. *See* Focal at 22 n.34; Global NAPs at 10 n.17.

fund would satisfy Section 254's requirement that federal mechanisms be "sufficient" to preserve and advance universal service. *Id.* ¶ 201.[8] A further reduction of price cap LECs' access charges thus would not threaten universal service; rather, such a transition is long overdue and necessary to eliminate uneconomic incentives in the current system.

The Commission recently announced its adoption of a similar plan for rate-of-return carriers. *FCC Adopts Order to Reform Interstate Access Charge System for Rural Carriers*, News Release, 2001 FCC LEXIS 5434, *2 (Oct. 11, 2001). As the Commission has indicated, its new rules will "align the interstate access rate structure more closely with the manner in which costs are incurred by driving per-minute access charges towards lower, more cost-based levels" and replace "implicit support for universal service with explicit support that is portable to all eligible telecommunications carriers on a competitively neutral basis." *Id.* The Commission should implement these new rules as soon as possible.

Moreover, not only are the incumbents' claims that reducing or eliminating access charges would require increases in retail rates unsubstantiated, but, even if proven, they would not justify keeping access charges above economic cost. Today's artificially high access charges result in severe economic distortions and should be eliminated as soon as possible. Five years after passage of the 1996 Act, the lack of cost-based rates in intercarrier compensation schemes continues to retard the development of competition. The Commission should establish

[8] To be sure, the Fifth Circuit recently found that the Commission did not supply a sufficient explanation for the $650 million figure and remanded that issue to the Commission for further consideration. *Texas Office of Public Utility Counsel* v. *FCC*, 265 F.3d 313 (5th Cir. 2001) ("*TOPUC II*"). The Court noted in its opinion, however, that "the CALLS Order hints at some reasoned analysis," *id.* at 328, and the Commission should easily be able to supply the necessary explanation on remand.

economically rational and cost-based rates for these services, even if the Commission were to find that such cost-based rates require some increases to end-user rates.

In any event, the incumbents have not offered a shred of evidence to support their claims that local service rates are not self-sustaining with existing explicit universal service subsidies. Accordingly, the Commission should reject SBC's request (at 21) that "the Commission . . . immediately initiate a proceeding to establish inducements for states" to "increas[e] residential service prices to levels that are self-supporting." *See also* BellSouth at 5 n.7, 15-16. Even assuming that the Commission had statutory authority to undertake such a program of "inducements," none of the LECs has even attempted to demonstrate that such increases are necessary. To the contrary, the Commission can fully respond to the Tenth Circuit's recent remand in *Qwest Corp.* v. *FCC*, 258 F.3d 1191 (10th Cir. 2001) by providing a better explanation for the basic program it adopted in the *Ninth Report and Order* in the Universal Service Fund proceeding. *See Federal-State Joint Board on Universal Service*, Ninth Report and Order, 14 FCC Rcd. 20432 (1999), *rev'd and remanded sub nom. Qwest Corp*. v. *FCC*, 258 F.3d 1191 (10th Cir. 2001). In all events, even if there were some demonstrable need for rate increases to make local rates self-supporting, that would still provide no basis for sustaining bloated access charges but would need to be addressed at the retail level.

In short, the focus in this proceeding should be on identifying and implementing a *unified* intercarrier compensation regime that best promotes the Commission's goals of efficiency and competitive neutrality. As the comments confirm, that rule is cost-based CPNP.

II. A UNIFIED COST-BASED INTERCARRIER COMPENSATION RULE IS EFFICIENT.

There is little dispute that cost-based rates are both efficient and competitively neutral and would solve the problems of both "regulatory arbitrage" and "terminating access monopolies." As the commenters recognize, intercarrier charges appropriately calculated on the basis of long run, incremental costs (*i.e.*, "economic costs") replicate competitive market outcomes, preclude inefficient regulatory arbitrage, provide carriers with efficient incentives to invest in and use network facilities, and prevent carriers from imposing exorbitant termination charges. *See, e.g.,* C&W at 4; CompTel at 18-21; MD OPC at 20-22; MECA at 40; OPUCT at 38-39. *See also Local Competition Order* ¶ 675 ("In competitive markets, the price of a good or service will tend towards its long-run incremental cost"). The vast majority of commenters therefore agree with CompTel that "[n]owhere [has the Commission] identified a systemic failure in the CPNP system codified in the Act." CompTel at 9. Rather, the problems identified in the *Notice*, to the extent that they are problems at all, are the result of *departures* from cost-based rates. Accordingly, the Commission should not make radical changes to the entire system of intercarrier compensation – and, thereby, introduce new opportunities for arbitrage and monopoly abuse – but should instead simply mandate and enforce cost-based rates within the CPNP system.

Qwest attacks the efficiency of cost-based pricing, claiming (at 12) that it "may be conceptually impossible" to determine what termination rates are efficient. To the contrary, the Commission, applying established economic principles, has properly recognized that rates based on long run, incremental costs replicate the workings of a competitive market and therefore, by definition, send efficient price signals. *See also Local Competition Order* ¶ 679 ("Because a pricing methodology based on forward-looking costs simulates the conditions in a competitive marketplace, it allows the requesting carrier to produce efficiently and to compete effectively . . . . We believe that our adoption of a forward-looking cost-based pricing methodology should facilitate competition on a reasonable and efficient basis by all firms in the industry by establishing prices for interconnection . . . based on costs similar to those incurred by the incumbents . . . ."). When call termination rates are set on the basis of long run, incremental costs, they (i) encourage carriers to make efficient decisions about whether to pay another carrier to provide call termination or to self-provide that service and (ii) provide carriers with the correct incentive to deploy assets that will be used to terminate calls for other carriers. AT&T, Ordover-Willig Decl. ¶¶ 38-41, 43-54; *see also Local Competition Order* ¶¶ 675, 679.[9]

Ultimately recognizing that there is no "conceptual" problem to cost-based pricing, Qwest retreats to the claim (at 14) that "pragmatic obstacles" to implementing cost-based pricing "might be insurmountable." Although estimating forward-looking costs is by no means "easy," the experiences of the parties, the state commissions, and the Commission over the past five years demonstrate that the difficulties Qwest identifies are by no means "insurmountable."

Qwest first complains that the costs of terminating calls to ISPs are not strictly usage sensitive, but that current reciprocal compensation rates are entirely usage sensitive. Qwest at 14. If Qwest's premise is true, this is simply a matter of rate design and does not call into question the legitimacy of cost-based pricing. AT&T, Ordover-Willig Decl. ¶ 24. Further, as Qwest ultimately concedes, to the extent that significant costs are incurred to supply capacity to

[9] Global NAPs argues (at 2-3) that it does not matter whether cost-based CPNP or B&K is more efficient, because, under the Coase theorem, the parties will negotiate to the efficient solution. There are several problems with this argument. First, if the Commission were to pick an inefficient default rule (*i.e.*, B&K), the Commission would effectively require carriers to *pay* for the privilege of operating under the more efficient CPNP rule. Second, as Professor Coase himself recognized, the efficient rule is necessarily reached only when transaction costs are zero. R. Coase, *The Firm, The Market, and the Law* 114-19 (1998). The costs of negotiating away from the B&K rule might be sufficiently high that CPNP would not be universally adopted despite its efficiency benefits. In any event, these unnecessary transaction costs are a dead weight loss to society and would be eliminated by specifying the efficient rule from the outset.

handle peak usage, this issue can be addressed through two-part rate design – *i.e.*, separate charges for capacity plus traffic-sensitive usage.

Qwest next observes (at 14) that, as the technology deployed in telecommunications networks changes, the forward-looking costs of call termination may change, and regulators may not be able "to keep pace with the latest cost-reducing developments." Qwest appears confused about how forward-looking costs are calculated in practice. Speculative, unproven technologies are *not* included in cost studies. Thus, forward-looking cost studies do not, as Qwest suggests, need to be updated as soon as a new technology appears on the horizon. Rather, recent technologies are included in forward-looking cost studies only to the extent that they are proven and actually commercially available. Further, state commissions typically set rates that remain in place for years. Thus, the current way that rates are set reasonably balances the need to account for newly developed technologies with administrative feasibility, with state commissions always retaining the ability to alter rates to reflect the impact of any proven, commercially available technological developments that impact the costs of providing telecommunications services.

Qwest also argues (at 14) that cost-based pricing requires regulators to determine costs for not just ILECs, but also for CLECs, and that, given the number of CLECs, this is not feasible. But as explained by Professors Ordover and Willig (¶¶ 90-93), the use of "symmetrical rates" – *i.e.*, basing CLEC termination rates on ILEC termination rates – is consistent with forward-looking pricing principles, provides incentive for efficient supply, and is required by principles of competitive neutrality.

In any event, Qwest is ultimately arguing with itself, because its preferred B&K approach does not eliminate the need for price regulation or cost estimation. Rather, as Dr. DeGraba recognizes, B&K simply shifts the focus of that regulation:

> Implementation of a COBAK regime for intercarrier compensation will *not* reduce or eliminate many of the underlying sources of market power possessed by incumbent LECs. . . . Nor will COBAK eliminate other advantages that incumbent LECs enjoy as a result of decades of operation as government-sanctioned monopolies. Incumbent LECs . . . would retain under COBAK existing incentives and abilities to exercise market power and disadvantage their rivals, thereby limiting the development of efficient competition and harming consumers.

WorldCom, DeGraba Decl. at 4 (emphasis added). In particular, ILECs subject to a B&K rule would, absent regulation, be able to collect from end users monopoly rates for charges that they now recover from other carriers. AT&T, Ordover-Willig Decl. ¶¶ 22-23. Absent cost-based regulation of these end user rates, ILECs would also "be able to disadvantage rival [IXCs] by recovering these costs from customers of competing IXCs with a less efficient rate structure than that used to recover the same costs from customers of their own interexchange service." WorldCom, DeGraba Decl. at 5; *see also* AT&T, Ordover-Willig Decl. ¶¶ 22-23.

As a consequence, so long as ILECs retain market power – and for the foreseeable future, that is a given – the "deregulatory" virtues of B&K are illusory. *Id.* ¶ 24. Rate regulation to protect consumers and competitors from incumbent abuses is just as necessary under B&K as it is under cost-based CPNP. WorldCom, DeGraba Decl. at 4-6; AT&T, Ordover-Willig Decl. ¶ 24. As such, the pricing issues that Qwest says are "unsolvable" under CPNP are, in fact, unavoidable.[10]

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[10] For the same reasons, the incumbents' requests for "pricing flexibility" that would eliminate oversight of end user rates are meritless. *See* Qwest at 5-6; SBC at 32; BellSouth at 15.

Although it does not challenge the fact that cost-based rates promote economic efficiency, Sprint argues that CPNP is inappropriate because both the called and calling parties are "joint" cost causers. Sprint at 14-15; *see also* C&W at 7; Qwest at 20-21. Although Professors Ordover and Willig have explained (¶ 27) why the calling party is the true cost causer,[11] it is ultimately unnecessary to resolve this issue. That is because phone calls have both positive and negative externalities. Thus, regardless of whether or not the calling party is the sole cost causer, the critical issue is whether a particular intercarrier compensation regime provides a mechanism to allow the two parties to internalize properly these externalities. Regardless of who "causes" the costs of a call, the intercarrier compensation regime that better enables the parties to internalize externalities will promote more efficient usage. AT&T, Ordover-Willig Decl. ¶ 29 ("the search must be for the rule that minimizes negative externalities by forcing callers to at least internalize all of the direct costs associated with their calls, but also is flexible enough to allow calling and called parties to internalize positive externalities").

CPNP, to the best extent possible, permits internalization of both positive and negative externalities associated with a call. AT&T, Ordover-Willig Decl. ¶¶ 29-31; NASUCA at 22. In the case of unwanted calls (*i.e.*, the negative externality), CPNP requires the calling party to internalize a greater portion of the costs caused by the call which limits incentives to make unwanted calls. On the other hand, CPNP is sufficiently flexible to allow the alignment of costs and benefits in connection with the positive externalities associated with mutually beneficial calls. CPNP permits carriers to use 800 numbers and other similar services to handle situations

[11] Qwest unintentionally demonstrates why B&K cannot be consistent with any plausible theory of cost-causation. In its comments, Qwest observes (at 20) that the called party has no way of avoiding his carrier's call set up charges. The calling party is unquestionably the cost causer of such costs.

where the called party primarily benefits from a call. *See* Time Warner, Farrell-Hermalin Decl. at 5 n.4. More generally, there are a variety of conventions that allow called and calling parties to "shift," and thereby, to align the costs of calls with the corresponding benefits of calls. *See* AT&T, Ordover-Willig Decl. ¶ 30 ("For example, consumers often agree . . . to take turns calling each other so that each bears the full costs of the share of calls that roughly reflects that party's share of the total benefits associated with their calls. Similarly, consumers can adjust the length of time they talk to each other when one party is paying in order to account for the relative costs/benefits").

III. B&K WOULD BE INEFFICIENT.

The comments likewise confirm that B&K would be inefficient. First, the commenters identify numerous flaws, both theoretical and empirical, with the Commission's attempt to justify B&K on the basis of cost causation. In addition, the commenters detail numerous practical problems that would arise under B&K that do not exist today under CPNP, including incentives to serve only originating traffic, the need for new regulation, and the increased ability of incumbents to discriminate against their competitors.

A. B&K Would Not Send Correct Economic Signals.

The *Notice*'s principal economic argument in favor of B&K is that it would promote more efficient network usage than CPNP. *Notice* ¶ 37. The *Notice* reasons (*id.*) that this is so because B&K – by requiring each party's network to bear its own costs – accounts for the "fact" that both parties to a call "benefit" from a call. Each step in this line of thinking is flawed.

First, and most fundamentally, the *Notice* ignores the fact that an efficient intercarrier compensation scheme must account not only for the positive externalities associated with calls, but also for the negative externalities that occur where the called party does not want to be called. *See* AT&T, Ordover-Willig Decl. ¶ 28. As explained above, CPNP both minimizes negative externalities by forcing callers to bear all of the direct costs of unwanted calls *and* is sufficiently flexible to allow the called and calling parties to internalize positive externalities (by, for example, taking turns calling each other and adjusting the length of time that they talk when one party calls the other). A B&K rule, in contrast, would not only encourage more unwanted calls (*e.g.*, by effectively allowing telemarketers to terminate their calls for free), but also would force the unfortunate recipients of such calls to pay for the "pleasure" of receiving interruptions. As CompTel observes (at 16), "it is hard to imagine that the public interest would be served by forcing families to pay higher costs for calls from telemarketers or political pollsters that interrupt their dinner."

Further, even if it were true that both parties to a call benefit from the call, it is not true that the same relative benefits will obtain for every call. The actual B&K schemes endorsed by the *Notice*, however, rigidly assume that the two parties always benefit equally. That is simply incorrect. *See, e.g.*, Ad Hoc at 5 (assumption that parties benefit equally is "unproven and likely untrue"); TOPUC at 56. None of the proponents of B&K offers any empirical proof for such a proposition, and simple common sense suggests that the relative benefits in fact vary enormously. As CompTel explains (at 15), "[i]n some circumstances, none of the parties to a call accrue a benefit (*e.g.*, a misdial)"; "[i]n other circumstances, only the calling party accrues any benefits (*e.g.*, a telemarketer disturbing a family during dinner)"; and "both parties to a call may accrue benefits . . . although the benefits will almost never be split on a 50/50 basis." *See also* Allegiance at 21 ("The proliferation and popularity of products designed to screen unwanted calls appear to flatly contradict the assumption . . . that the calling and called parties . . . benefit equally from" calls). Thus, B&K would almost always send *inaccurate* economic signals to both parties.

Moreover, even if it were reasonable to pretend that both parties to a call always benefit from the call and that they benefit equally, B&K is not tailored to achieve even that split. The percentage of costs borne by each party to a call would not be 50 percent, but the relative percentage of costs that happen to be attributable to each carrier's network – a measure that bears no logical relation to the split of "benefits" the parties to the call purportedly receive.[12] In all of these ways, B&K would not accurately track the relative benefits experienced by each party to a call.

B. B&K Would Create A Host of New Problems, Including Uneconomic Incentives, Increased Regulation, And Opportunities For Anticompetitive Discrimination Against Non-Incumbents.

The comments also confirm that a switch to B&K cannot be justified on the grounds that it somehow eliminates existing "arbitrage" opportunities while reducing the need for Commission intervention in the marketplace. As explained above, and in AT&T's opening comments, the pressing "problems" identified in the *Notice* are the result of the failure to *apply* cost-based rates consistently and do not call into question the efficiency of cost-based CPNP. In stark contrast, B&K – by divorcing rates from costs – would open a Pandora's Box of new arbitrage and regulatory problems. Indeed, most of the testimony provided by the author of COBAK, Dr. DeGraba, details the numerous new ways in which B&K would "create new

[12] As Drs. Farrell and Hermalin point out, Dr. DeGraba's argument for the efficiency of B&K, which explicitly assumes a 50/50 split of benefits, also implicitly assumes that the costs of two interconnected networks are the same. Time Warner, Farrell-Hermalin Decl. at 4. That may not be true, especially in the context of ILEC-CLEC interconnection, because the two networks may use different technologies. *Id.* As Drs. Farrell and Hermalin note, COBAK also assumes that (continued . . .)

opportunities" to foreclose competition, WorldCom, DeGraba Decl. at 12-24, which, in turn, would require the Commission to adopt a host of new regulations to combat the exercise of incumbent market power.

For example, the Commission's overriding goal in establishing B&K seems to be the elimination of the ISP-bound traffic "problem," but as numerous commenters note, B&K would merely establish the opposite problem – *i.e.*, the creation of inefficient incentives to serve customers that primarily originate calls. *See, e.g.,* Ad Hoc at 3 n.3; Time Warner, Farrell-Hermalin Decl. at 6; Md. OPC at 27-28; TOPUC at 18-19. Even Qwest concedes that B&K would create such incentives. *See* Qwest at 19. Relatedly, as the Maryland OPC explains, B&K would create an incentive for end users to claim to be "carriers" to avoid paying LEC local switching charges. Md. OPC at 2-3.

Sprint claims that this is not so, but its arguments ignore fundamental principles of economics. Sprint argues that, under B&K, serving a customer with predominantly originating traffic results only in "cost savings," rather than "additional revenues." Sprint at 11. Sprint asserts that these cost savings would be realized only "when a transition is made from a [CPNP] regime to a bill and keep regime," but that there would be no incentive to seek originating customers after the transition. *Id.* That makes no sense. If two customers can be charged the same amount for phone service, but one costs less to serve than the other, then there is an undeniable incentive to serve the lower-cost customer.

(. . . continued)
traffic-sensitive retail markups by the carriers are the same, but in fact traffic-sensitive retail mark-ups may differ depending on the carrier's market power. *Id.* at 5.

Additionally, Sprint's example purporting to show that a carrier would be indifferent to whether customers originate or terminate more traffic is rigged to produce equivalent costs. *See* Sprint at 12. Instead of Sprint's example, assume that Customer X has 400 minutes which both originate and terminate on Carrier A's network and that Customer Y has 400 minutes which originate on Carrier A's network but terminate on another carrier's network. There is no question that Customer Y is cheaper for a given carrier to serve under B&K, which creates an incentive to target Customer Y. Moreover, the "cost savings" that result from targeting and winning customers like Customer Y would permit Carrier A to price its services below those of carriers with more balanced traffic flows, thus allowing such carriers to win a disproportionate amount of business from customers with predominantly originating traffic. This mathematical reality cannot be seriously disputed; it would be naive to think that the Commission could reduce the cost of terminating traffic on other networks to zero without creating substantial economic incentives to shift termination to other networks.

Sprint's alternative argument that CLECs could not effectively target and attract customers with primarily originating traffic is equally incorrect. *See* Sprint at 13. To the contrary, CLECs could easily adopt pricing plans designed to attract telemarketers and other net originators of traffic. In fact, existing CLEC tariffs already permit customers to buy outbound-only calling services.

Thus, B&K would inevitably create a set of self-reinforcing trends. B&K would dramatically reduce the cost of originating calls, thereby increasing the demand for telecommunications services from telemarketers and other net originators (major sources of unwanted calls and negative externalities); as CLECs move to meet that demand with offerings tailored to such customers, competition will likely further decrease the price of origination and, thus, further increase the activities of telemarketers; and ILECs would be increasingly "stuck" with a disproportionate amount of terminating traffic. None of this is in the public interest.[13]

B&K would also inevitably lead to endless disputes over how to define a "central office" or other point of demarcation between networks. This is a critical issue because, at least under COBAK, the central office marks the point at which the terminating carrier begins bearing the costs of terminating traffic. Thus, a terminating carrier has an incentive to have the central office be defined as close to the "edge" of its network as possible. As Qwest explains (at 22), how to define a central office for these purposes is "complex" and requires additional "extensive comment" – belying any notion that B&K could be easily implemented.

In the context of access services, B&K would give ILECs unilateral control over trunking decisions, thus providing incumbents with a powerful means of discriminating against their IXC competitors. *See, e.g.*, WorldCom at 24 & DeGraba Decl. at 12-15; AT&T at 48-49. By devoting insufficient trunking resources to long distance competitors, the incumbent could increase the incidence of call blocking. AT&T at 49 & Ordover-Willig Decl. ¶ 60. Relatedly, B&K would allow ILECs to use end user termination charge rate design (which would replace existing access charges assessed on carriers) to favor their long distance, information service, and advanced service affiliates at the expense of competing providers. AT&T at 49.

[13] Qwest argues (at 19) that the danger of carriers targeting originating traffic under B&K "may have been somewhat overstated," because (as the Commission speculated in the *ISP Remand Order*) the fact that under B&K a carrier recovers its switching costs "from the originating end-user, not from other carriers" means that originating traffic "lacks the same opportunity for cost-shifting" that the CPNP regime provides. *See id.* (quoting *ISP Remand Order* ¶ 73). But the mere fact that switching costs are recovered from end-users under B&K instead of from other carriers has nothing to do with whether cost-shifting can occur. As explained above, CLECs have ample means to target originating traffic, and thus, to shift the costs of terminating traffic disproportionately to incumbent carriers.

And B&K would eliminate an important check on UNE prices, insofar as the current system gives incumbents an incentive to argue for lower prices for the switching element. *See, e.g.*, *id.* at 32-33. Under today's system, state commissions typically adopt UNE switching rates when determining the appropriate rates for reciprocal compensation. Because of the risk that they could be net payors of reciprocal compensation, ILECs currently have at least some imperfect incentives to seek reasonable, cost-based UNE switching rates in order to lower their potential reciprocal compensation payments.

As these examples make clear, the notion that B&K is more deregulatory is wrong. Nothing in B&K magically eliminates existing ILEC market power. So long as ILECs retain monopoly power over the relevant facilities, simply transforming carrier charges into end-user charges, as B&K would do, would require the Commission and the state commissions to change the focus of regulation from carrier charges to the new end-user charges that replace them. AT&T, Ordover-Willig Decl. ¶¶ 20-22. And, as the discussion above makes clear, converting existing intercarrier charges to end-user charges would create additional means for ILECs to engage in anticompetitive conduct, remove existing constraints that moderate some ILEC charges for monopoly network elements, create new arbitrage opportunities, and require the Commission to adopt regulations to deal with new problems such as disputes regarding the definition of a central office.

Worse yet, taken to its logical extreme, the theory underlying B&K would require the Commission and the state commissions to establish new regulation for the end-user prices of *all* calls, not just calls that involve more than one carrier. The theory that both parties benefit equally from a telephone call and that both parties should, therefore, split the costs of the call applies equally to *intra*-carrier calls. The theory underlying B&K, thus, is an attack not only on

CPNP, but on the *entire concept of sent-paid calls*. If that theory were correct (which it is not), state commissions would have to redesign local retail rates to ensure that called parties paid the cost of terminating all calls, even if the call originated on the called party's network, in order to ensure that both the calling and called parties received the correct "economic signals." *Cf.* Ad Hoc at 4-5; Focal, ETI Paper at 43.

Indeed, under B&K, CLECs' customers would have to pay for virtually all incoming calls, because they would be receiving calls almost exclusively from customers of the incumbent (or other LECs). Unless all LECs were required to charge for all incoming calls, the incumbents – whose customer bases are much larger and whose customers are mostly calling each other – could gain an enormous competitive advantage by offering pricing plans in which customers did not have to pay for most incoming calls. Adopting B&K for all local calls would thus be profoundly anticompetitive, absent extensive new regulation of retail pricing.

IV. COST-BASED CPNP IS LAWFUL AND B&K IS NOT.

A. Cost-Based Intercarrier Compensation Is Lawful.

Section 251(b)(5), coupled with Section 252(d)(2), require cost-based compensation for *all* telecommunications that interconnecting LECs exchange. 47 U.S.C. §§ 251(b)(5), 252(d)(2). The Commission has acknowledged as much in the *ISP Remand Order* (¶¶ 31, 34), where the Commission rejected its prior conclusion that Section 251(b)(5) applied only to "local" traffic and instead explained that Section 251(b)(5), "on its face," requires reciprocal compensation arrangements for "*all* 'telecommunications'" by interconnecting LECs. And Section 252(d)(2) provides that all traffic exchanged pursuant to Section 251(b)(5) must be at rates that "approximat[e] . . . the additional *costs* of terminating such calls." 47 U.S.C. § 252(d)(2)(A)(ii) (emphasis added). *See also id.* § 252(d)(2)(A)(i) (under Section 251(b)(5), reciprocal compensation rates must "provide for the mutual and reciprocal recovery by each carrier of costs associated with transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carriers").

Nor does Section 251(g) alter that conclusion. Although Section 251(g) "grandfathers" certain pre-existing interstate access "obligations" and "restrictions" imposed on LECs that previously were subject to consent decrees when the 1996 Act was passed by Congress, the Commission properly has recognized that Section 251(g) is merely a "transitional enforcement mechanism" that prevents a flash-cut from those pre-existing requirements as the Commission moves toward implementation of the cost-based requirements of the Act. *See Deployment of Wireline Servs. Offering Advanced Telecomms. Servs.*, Order on Remand, 15 FCC Rcd. 385, ¶ 47 (1999). Indeed, the Commission has already begun the transition to cost-based rates for some interstate access charges and it should do the same for other interstate charges.[14] As the Commission continues to adopt regulations that supersede the pre-1996 Act "obligations" and "restrictions" on LECs with respect to their dealings with IXCs, those superseding regulations, of course, must conform to the applicable requirements of Sections 251 and 252, including the reciprocal compensation requirements applicable to interconnecting LECs, as reflected in Sections 251(b)(5) and 252(d)(2).

And, contrary to Qwest's claim (at 45), Section 251(g) has no application at all to intrastate access charges. Section 251(g) provides for a transition period for pre-existing

[14] *See*, *e.g.*, *FCC Adopts Order to Reform Interstate Access Charge System for Rural Carriers*, New Release, 2001 FCC LEXIS 5434, *2 (Oct. 11, 2001) (announcing FCC action designed to "align the interstate access rate structure more closely with the manner in which costs are incurred by driving per-minute access charges towards lower, more cost-based levels"); *TOPUC II*, 265 F.3d at 324 (noting that Congress, in the 1996 Act, "established the goal that network
(continued . . .)

interstate access charge rules that previously were subject to consent decrees when the 1996 Act was passed by Congress. 47 U.S.C. § 251(g). To be sure, the *ISP Remand Order* reached a different result, but on the basis of fundamentally flawed logic. In particular, the Commission there concluded that it would be "'incongruous'" to interpret Section 251(b)(5) as applying to "'traffic subject to parallel intrastate access regulations.'" *ISP Remand Order* ¶ 37 n.66 (quoting *Local Competition Order* ¶ 732). But that statement cannot be reconciled with the plain text of Sections 251(b)(5) and 251(g), which provides that interconnecting LECs must enter into such arrangements for the transport and termination of "telecommunications," *id.* § 251(b)(5), and that only certain interstate consent decree obligations and pre-existing Commission access regulations are grandfathered by Section 251(g).[15] *See ISP Remand Order* ¶ 37 n.66

In fact, the Commission's analysis on this point is internally inconsistent. On the one hand, the Commission acknowledges that Section 251(b)(5), "on its face," applies to "*all* telecommunications" between interconnecting LECs unless "further limited" by Section 251(g). *ISP Remand Order* ¶¶ 31, 32. The Commission then candidly acknowledges that Section 251(g) cannot limit the application of Section 251(b)(5) with respect to "intrastate access regimes" because Section 251(g) "expressly preserves only *the Commission'*s traditional policies and authority over *interstate* access services." *id.* ¶ 37 n.66 (emphasis added). Nevertheless, the Commission then manufactures out of whole cloth its own "further limitation" on the clear language of Section 251(b)(5) because it purportedly would be "incongruous" to conclude that

(. . . continued)
access charges should eventually reflect the actual costs of providing and administering the particular network service").

[15] Even Qwest acknowledges (at 46) that the Commission's conclusion that "intrastate access traffic" falls outside of Section 251(b)(5) "may not be compelled by the statutory language."

Congress was not also concerned about the effects "'on analogous intrastate mechanisms.'" *Id.* (quoting *Local Competition Order,* ¶ 732).

The *ISP Remand Order*'s faulty logic cannot be overlooked on the ground that the term "telecommunications" is in any way "ambiguous." Congress has separately defined "telecommunications" as the "transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent or received." 47 U.S.C. § 153(43). There is no dispute that intrastate access services fall squarely within this statutory definition.

Nor can the Act's plain language be discarded based upon the Commission's belief that it would engender an "absurd" or "incongruous" result. The Supreme Court long ago explained that allowing "consequences thought to be absurd" to justify a departure from the plain meaning of a statute "call[s] rather for great caution and circumspection to avoid usurpation of the [legislative power]." *Crooks* v. *Harrelson*, 282 U.S. 55, 60 (1930). Indeed, this rule of construction has been described as a "narrow" one, applicable only if "the plain meaning of the statute would lead to 'patently absurd consequences' that 'Congress could not *possibly* have intended.'" *Public Citizen* v. *United States Dep't of Justice*, 491 U.S. 440, 470 (1989) (Kennedy, J., concurring in judgment). Here, there can be no claim that "Congress could not *possibly* have intended" to apply the reciprocal compensation obligations reflected in Section 251(b)(5) to interstate access regimes to ensure that the costs for termination and transport between LECs would be cost-based.

Moreover, cost-based rates are mandated not only for transport and termination by interconnecting LECs, but also for "origination" of access traffic under Section 254(e) and Section 254(k). Section 254(e) governs universal service support payments and provides that "[a]ny such support should be explicit . . . ." 47 U.S.C. § 254(e). Further, Section 254(k) prohibits subsidies for competitive services and provides that the FCC and the States must ensure that "services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services." *Id.* § 254(k). Taken together, these provisions mandate that there can be no implicit subsidies for "intrastate" and "interstate services" that are subject to universal service support. *Id.* §§ 254(e), (k). That is, "requiring carriers to recover their contributions [for universal service] from access charges on interstate calls shifts the costs of intrastate universal service to the interstate jurisdiction" and results in "an implicit subsidy" in violation of Section 254. *Texas Office of Pub. Util. Counsel* v. *FCC*, 183 F.3d 393, 425 (5th Cir. 1999) ("*TOPUC I*"). Further, in *Comsat Corp*. v. *FCC*, the Fifth Circuit extended that holding by striking down a Commission ruling that "permitt[ed] the ILECs to recoup universal service costs through access charges" because that result was "contrary to the plain language of § 254(e)." 250 F.3d 931, 939-40 (5th Cir. 2001). In short, any above-cost origination costs that IXCs must pay to ILECs are, by definition, an implicit subsidy to the carrier responsible for origination and, therefore, violate Section 254.

B. An Across-the-Board B&K Rule Would Be Unlawful.

The comments confirm the conclusion that the Commission cannot, consistent with the Communications Act, adopt an across-the-board B&K rule. The plain language of Section 251(b)(5) mandates "reciprocal compensation" for the "transport and termination" of *all* "telecommunications" between interconnecting LECs, and Section 252(d)(2) mandates that such arrangements must "provide for the mutual and reciprocal recovery by each carrier" of "*costs* associated with the transport and termination" of calls that originate on the network of the other carrier. Nonetheless, a number of the commenters ask the Commission to ignore the language of

Section 252(d)(2) and to impose a B&K system in situations even where it would fail to provide LECs with "mutual recovery of costs" by forcing a carrier to terminate traffic for another carrier without any compensation. *See* BellSouth at 17-18; Qwest 40-47; SBC Communications 38-48; Sprint 19-22. These arguments, however, cannot survive review.

First, Qwest argues (at 40) that the Commission was mistaken in adopting the "policy" in the *Local Competition Order* that Section 252(d)(2) does not permit B&K for unbalanced traffic. Qwest's arguments fail at the outset because the *Local Competition Order* was neither compelled nor animated merely by policy concerns but, rather, by the plain language of the statute. *See Local Competition Order* ¶ 1112 (explaining that (i) "Section 252(d)(2)(A)(i) provides that to be just and reasonable, reciprocal compensation must 'provide for the mutual and reciprocal recovery by each carrier of costs associated with transport and termination,'" (ii) "carriers incur costs in terminating traffic that are not *de minimis*," and (iii) "consequently, bill-and-keep arrangements that lack any provisions for compensation do not provide for recovery of costs"). As a result, those determinations can only be amended by Congress – and not the Commission – because where, as here, "the intent of Congress is clear, that is the end of the matter; for the court, as well as agency, must give effect to the unambiguously expressed intent of Congress." *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.* 467 U.S. 837, 842-43 (1984).

In the alternative, Qwest argues (at 43) that Section 252(d)(2) provides carriers with two mutually exclusive options: Under subsection (A) of Section 252(d)(2), carriers can choose to adopt a CPNP arrangement that ensures the "mutual and reciprocal recovery by each carrier of costs" or, under subsection (B), they can utterly ignore that requirement and instead adopt a B&K system that "waive[s] mutual recovery." But that interpretation reads subsection (B) out of the statute because it provides that compensation schemes such as B&K are permissible only where they "afford the mutual recovery of costs," 47 U.S.C. § 252(d)(2)(B)(i), *i.e.*, as the Commission has already held, when traffic between the two LECS is "roughly in balance . . . and neither carrier has rebutted the presumption of symmetrical rates." *Local Competition Order* ¶ 1112. Simply put, Section 252(d)(2)(B) cannot reasonably be read, as Qwest suggests, to be internally inconsistent and, thereby, "'to destroy itself." *AT&T Corp.* v. *Central Office Tel., Inc.*, 524 U.S. 214, 228 (1998) (quoting *Texas & Pac. R.* v. *Abilene Cotton Oil Co.,* 204 U.S. 426, 446 (1907)). Rather, it must be read, as the Commission did in its *Local Competition Order*, to permit arrangements that "waive mutual recovery" when those arrangements, through the "offsetting of reciprocal obligations" "afford[s] mutual recovery of costs." 47 U.S.C. § 252(d)(2)(B)(i).

Finally, Qwest asserts (at 42) that the "additional costs" of transport and termination can be set "at zero" and, therefore, there is no tension between B&K and Section 252(d)(2). The Commission, however, has concluded that the costs recoverable under Section 252(d)(2) with respect to transport and termination are "not *de minimis,*" *Local Competition Order* ¶ 1112, and therefore cannot be "set . . . at zero," Qwest at 42. That conclusion is confirmed by the (non-zero) transport and termination rates set by state regulatory commissions. Qwest provides no change in circumstances or other persuasive reason for the Commission to reject its findings on this point.

The arguments advanced by the other RBOCs are equally meritless. BellSouth and SBC are simply wrong in contending that Sections 251(b)(5) and 252(d)(2) are satisfied if each carrier is permitted to "recover[] its own costs of transport and termination from end-user customers." BellSouth at 18; SBC at 43-44. To the contrary, Section 252(d)(2) requires that carriers receive "mutual *and* reciprocal recovery" of their costs. 47 U.S.C. § 252(d)(2)(A)(i). That requirement is not satisfied if carriers are forced to recover *unilaterally* those costs, *i.e.*, from their own customers, rather than reciprocally, *i.e.*, from the other carrier. Indeed, "reciprocal" obligations commonly are understood to mean those that are "[g]iven or owed mutually as between two persons," *i.e.*, "[r]eciprocal obligations are those due from one person to another and vice versa." *Black's Law Dictionary* 1269 (6th ed. 1990). More specifically, the D.C. Circuit has adopted this view with respect to the requirements of Section 251(b)(5) by explaining that reciprocal compensation means that "when a customer of carrier X calls a customer of carrier Y who is within the same local calling area, Carrier X pays Carrier Y for completing, or 'terminating' the call." *Global NAPs, Inc.* v. *FCC*, 247 F.3d 252, 253 (D.C. Cir. 2001); *Bell Atlantic Tel. Cos.* v. *FCC*, 206 F.3d 1, 4 (D.C. Cir. 2000) (same). Indeed, contrary to SBC's position, Section 252(d)(2)(B) confirms that carriers must be able to recover these costs from one another – and not from end users – by permitting B&K arrangements only when they "afford the mutual recovery of costs *through the offsetting of reciprocal obligations,*" 47 U.S.C. § 252(d)(2)(B)(i) (emphasis added), that is, obligations that one carrier owes to the other, and not, obligations that third-party consumers would, in SBC's view, owe to individual carriers.

Likewise, Section 251(g) does not exempt ISP-bound traffic from the Act's reciprocal compensation regime and is not an independent grant of authority through which the Commission indefinitely can avoid implementation of the requirements of Sections 251(b)(5) and 252(d)(2). SBC at 38-39; BellSouth at 19. As to the former, AT&T has explained that Section 251(g) does not apply to the LEC-to-LEC reciprocal compensation structure for ISP-bound traffic and does not give the Commission a license to implement regulations that flout the requirements of Section 251(b)(5). *See* AT&T Comments at 43-46.

As to the ILECs' latter point, the claim that Section 251(g) is an independent grant of authority is foreclosed by settled and controlling precedent. *See AT&T Corp.* v. *Iowa Utils. Bd.*, 525 U.S. 366, 381 & nn.8-9 (1999). In *Iowa Utilities Board*, the Supreme Court held that the Commission's general rulemaking under Section 201(b) extended to the matters contained in the 1996 Act. *Id.* at 380. In doing so, the Court reasoned that the Commission necessarily needed regulatory authority to implement the local competition provisions of the 1996 Act. The Court rejected the argument that this authority to implement the 1996 Act was contained in provisions including Section 251(g) because those provisions were not "conferrals of authority"; indeed, those provisions, including Section 251(g) "are not grants of authority at all." *Id.* at 383 nn.8, 9. Accordingly, the argument that Section 251(g) provides the Commission with stand-alone authority to ignore the requirements of Section 251(b)(5) is frivolous.[16]

Lastly, recognizing that Section 252(d)(2) stands as a barrier to adoption of across-the-board B&K, Sprint argues that the Commission may forbear from the requirements of Section 251(b)(5) and 252(d)(2). Sprint at 21-22. That argument also is baseless. Indeed, Sprint acknowledges that before the Commission may forbear, it must conclude that enforcement of Section 252(d)(2) is not necessary to ensure, among other things, that carrier practices are "just and reasonable." 47 U.S.C. § 160(a) (setting forth statutory forbearance standards). But Section

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[16] BellSouth makes the specious claim that the Commission can ignore the dictates of Sections 251(b)(5) and 252(d)(2) by mandating interconnection under Section 251(a). Plainly, the Commission's authority over interconnection in subsection 251(a) is circumscribed by the limitations included in Section 251(b)(5) and Section 252(d)(2). Indeed, Section 252(d)(2) is clear that the "terms and conditions for reciprocal compensation" are not "just and reasonable" unless they provide "for the mutual and reciprocal recovery by each carrier of the costs associated with the transport and termination . . . of calls that originate on the network facilities of the other carrier." 47 U.S.C. § 252(d)(2)(A)(i). Contrary to BellSouth's argument, the Commission's authority over interconnection does not include a license to sanction terms and conditions of interconnection that are not "just and reasonable." *Id.* § 252(d)(2)(A).

252(d)(2) – the provision from which Sprint seeks forbearance – itself prescribes that reciprocal compensation arrangements will not be "just and reasonable" if they fail to ensure the "mutual and reciprocal recovery of costs." *Id.* § 252(d)(2)(A)(i). As a result, Sprint has not and cannot demonstrate that the mandatory forbearance requirements of Section 160(a) have been satisfied. *See* AT&T at 39-40 & nn.29-31 (citing cases and explaining that forbearance criteria have not been satisfied with respect to Section 252(d)(2)).

V. THE COMMISSION'S EXISTING INTERCONNECTION RULES ARE EFFICIENT AND SHOULD BE RETAINED.

Having already obtained all of the intercarrier compensation reform that they desire – rules that unlawfully and inequitably single out ISP-bound traffic for a transition to bill-and-keep – the ILECs do not even attempt to advance the goal of this proceeding to develop a unified, efficient and lawful intercarrier compensation regime. Instead, at the same time that this Commission has announced that it intends to look for new ways to promote facilities-based competition,[17] the ILECs seek to use this proceeding to undermine the efficient interconnection rules that the Commission adopted in the landmark *Local Competition Order*, and thereby, to subvert the 1996 Act and the competitive landscape in additional ways. The incumbents' interconnection proposals are as unlawful as they are anticompetitive. As numerous commenters demonstrate – including the incumbents' own wireless affiliates, *see* Verizon Wireless at 30-34 – the existing rules are both mandated by the 1996 Act and critical to meaningful facilities-based competition. *See, e.g.*, Allegiance at 1-2 ("The initial [interconnection] rules implementing the 1996 Act . . . established an even-handed opportunity for incumbent LECs . . . and competitive LECs . . . to design and interconnect their networks efficiently"); Cablevision Lightpath at 2

[17] *See* Powell Stresses Need for Facilities Based Competition, *Communications Daily*, 2001 WL 5054280 (Oct. 24, 2001).

(replacing existing interconnection rules with incumbents' proposals would "impose[] crippling costs upon [CLECs] for choosing to employ new and more efficient networks"); Focal at 55 (the Commission's existing rules are based on "sound engineering principles" and are technologically neutral).

Adopting the incumbents' proposed interconnection rules would do great harm to consumers. As AOL demonstrates (at 7), for example, the incumbents' interconnection rules would effectively kill flat-rated Internet access service for rural customers by preventing CLECs from offering services which allow rural customers to make local-rated calls to an ISP physically located outside of the incumbent's rural local calling area. Prohibiting the use of "virtual" NXX codes would also put an end to large local calling areas for wireless service and force wireless carriers to offer local calling areas that mimic existing incumbent landline local calling areas. And that is precisely why Verizon, the nation's largest wireless provider, seeks an unprincipled CMRS exception to the anticompetitive NXX limits that it advocates for competitive wireline carriers. *See* Verizon at 8 n.16.

But the harm to consumers would not be limited to rural and wireless customers. Recent developments confirm that local competition cannot survive any further tilting of the playing field in favor of the incumbents. At bottom, the interconnection rules that the incumbents seek would leave potential new entrants no choice but to replicate the idiosyncratic architecture of the incumbents' ubiquitous, ratepayer-financed networks. As the incumbents recognize, that is not remotely economically feasible – which is the principal reason why Congress passed the 1996 Act in the first place. ILECs' anticompetitive practices have left capital markets all but closed to CLECs, and hardly a month goes by without the filing of new bankruptcy petitions. Indeed, scores of new entrant carriers have been driven into bankruptcy, and few are expected to emerge.

See New Paradigm Resources Group, Inc., *CLEC Report 2001*, at 1, 5 (14th ed.). As a result, the pace of competitive entry has slowed to a crawl. *Communications Today*, 2001 WL 6734021 (Aug. 17, 2001) (reporting that after gains in 2000, "[b]ankruptcies and layoffs have taken a toll on the CLEC sector [in 2001]," and that CLECs' line counts are expected to remain flat, if not decline). The interconnection rule changes that the incumbents seek here would all but guarantee that there could be no CLEC recovery and would doom to failure the Commission's implementation of the 1996 Act.

Points Of Interconnection. The ILECs urge the Commission to eliminate its existing point of interconnection ("POI") rules, which permit a CLEC to establish a single POI per LATA and make the originating carrier responsible for both getting its traffic to the POI and for paying the termination costs between the POI and the called party. *See* 47 C.F.R. §§ 51.321, 51.701(c), 51.701(e), 51.703(b), 51.705, 51.709(b); *Joint Application by SBC Communications, Inc., Southwestern Bell Tel. Co., & Southwestern Bell Commuications Servs., Inc., d/b/a Southwestern Bell Long Distance, Inc. for Provision of In-Region, InterLATA Servs. in Kansas & Oklahoma*, Mem. Op. & Order, 16 FCC Rcd. 6237, ¶ 235 (2001). The incumbents insist that they should instead be paid for originating any call from their customers that they must transport to a POI located outside of the local calling area of that customer and that they should have no obligations to compensate a CLEC for transport provided by the CLEC between the POI and the CLEC's switch. *See* SBC at 18; Qwest at 30 & n.15; USTA at 28.

These extreme proposals are foreclosed by the plain language of the Act. ILECs have a statutory duty to provide interconnection "at any technically feasible point" within their networks. 47 U.S.C. § 251(c)(2). They must also "establish reciprocal compensation arrangements," *id.* § 251(b)(5), that provide for the "mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier" and that do so through charges set at a "reasonable approximation of the additional costs of *terminating* such calls." *Id.* § 252(d)(2)(A)(i), (ii) (emphasis added). These provisions together establish that the CLEC designates POIs with incumbents (subject only to technical feasibility), that the POI marks the point at which the originating network must begin to pay reciprocal compensation to the terminating network, and that this compensation must cover the "additional" costs that the *terminating* carrier incurs in transporting and terminating traffic from the POI to the end user.

As the Georgia Public Service Commission observed in rejecting BellSouth's demand that CLECs "bear financial responsibility for the costs of hauling [a] local call outside the local calling area in which it originated," even

> [a]ssuming a CLEC's choice of interconnection at a single point in the LATA resulted in greater transport costs than if the CLEC established a POI in each local calling area within the LATA, it still does not lead to the conclusion that the CLEC should bear the costs of transporting the traffic to the POI. To draw such a conclusion would be to argue that a CLEC should pay a price for taking advantage of its rights under the Federal Act as construed by the FCC. Stated in the converse, it is to argue that an ILEC should receive additional compensation for meeting its duty under the Federal Act. Presumably, Congress believed imposing upon ILECs the specific interconnection obligations would best accomplish the goals of the legislation. Shifting cost recovery from [an ILEC] to a CLEC simply because a CLEC took advantage of its rights under the Federal Act would undermine this Congressional intent. As AT&T stated in its Brief [at 23], "It is a hollow gesture to allow CLECs to designate a single point of interconnection and then require CLECs to pay the difference of the cost of that single point of interconnection and the cost of multiple points of interconnection in every BellSouth basic local calling area."

Final Order, Docket No. 13542-U, at 3, 5-6 (Ga. PSC Order, July 23, 2001).[18]

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[18] *See also Bell Atlantic Interconnection Tariff*, D.T.E. 98-57, at 133 (Mass. DTE March 24, 2000); *Joint Petition of AT&T Communications of New York, Inc. et. al. Pursuant to Section 252(b) of the Telecommunications Act of 1996 for Arbitration to Establish an Interconnection*

(continued . . .)

Congress drew the line where it did because any other rule would create insurmountable barriers to competition. Deployment of transport facilities by CLECs requires the expenditure of substantial fixed costs. The deeper into the ILEC network that the CLEC must build, the smaller the volume of traffic carried by each individual facility, and, consequently, the higher the unit costs. As explained below, this is particularly problematic because ILECs employ many more switches than do CLECs to serve a comparable geography. Talbott-Schell Decl. ¶¶ 20-21 (attached hereto as Exhibit A). Instead, CLECs generally rely on relatively fewer switches and longer transport links. In effect, therefore, the ILECs' proposals would require CLECs to take the inefficient action of adopting the ILECs' network architecture. *Id.*[19] And new entrants simply do not have sufficient traffic volumes to justify the building of transport facilities to each and every incumbent central office or local calling area in a LATA. *See* Allegiance at 30-31.[20] Thus, as demonstrated in the attached declaration of David Talbott and John Schell, the ILECs' proposals would – as they are undoubtedly designed to do – create an enormous barrier to entry. AT&T has studied the cost of implementing the interconnection transport arrangements that BellSouth and Verizon proposed to the respective state commissions in recent interconnection agreement arbitrations in Florida, Georgia, and Virginia. The results of the studies show that the

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Agreement with Verizon New York, Inc., Order, Case No. 01-C-0095 (N.Y. PSC July 30, 2001) (rejecting Verizon's multiple POI proposal).

[19] Indeed, ILEC local calling areas are largely arbitrary – and often have been manipulated so as to maximize the toll revenue available to the ILEC.

[20] To ensure that CLECs cannot economically lease ILEC transport facilities to establish multiple POIs, the ILECs have argued before many state commissions that when CLECs lease transport for this purpose that they should have to pay supracompetitive *exchange access* rates rather than cost-based UNE rates. Similarly, ILECs have argued that CLECs should be allowed
(continued . . .)

ILECs' proposals that CLECs should bear the costs of transporting the ILEC's originating traffic from a point in each of the ILEC's local service areas to the CLEC's switch would more than quadruple AT&T's interconnection costs. Talbott-Schell Decl. ¶ 36.

SBC claims that the single POI rule "greatly diminishe[s]" CLEC "incentives to build their own networks," and that requiring CLECs to pay SBC and the other incumbents for the origination of traffic is therefore necessary to encourage facilities-based competition. SBC at 18. To the contrary, the numerous POIs through which AT&T and other CLECs currently are interconnected belie SBC's assertion, *see* Talbott-Schell Decl. ¶ 39, and, as explained above, adopting such a requirement would substantially increase the CLECs' costs of facilities-based entry and would further discourage such competition. When a CLEC initially enters a market, it generally deploys a single switch and establishes one or a few POIs with the incumbent near the focus of its initial entry. When it seeks to expand to surrounding communities, the most efficient option for the CLEC will often be to continue to use its initial POI, at least until its volume of customers and traffic in the surrounding areas will support another POI. The interaction between the location of the POI and the costs that a CLEC must bear provides the CLEC with strong incentives, once its volume of distant customers increases sufficiently, to establish an additional POI or POIs closer to the more distant communities. When the traffic being transported to and from distant customers rises to significant levels, the CLEC can be expected to reconsider its single POI configuration, as CLECs do today. *See* Allegiance at 27; WorldCom at 22; Time Warner at 14. Thus, as Professors Ordover and Willig explained (¶¶ 73-75), the existing rules

(. . . continued)
in this context to lease only dedicated transport facilities, even if they do not have sufficient traffic to justify such facilities. *See* Allegiance at 30-31.

are both efficient and necessary to enable meaningful local competition and promote efficient entry, and the incumbents' anticompetitive proposals to effect radical changes to those rules should be rejected. *See also* WorldCom at 22.

The Commission should likewise reject Sprint's flawed "compromise" proposal. Sprint suggests that a CLEC should, without exception, be obligated to establish an additional POI (or pay transport charges as if it had) whenever traffic at an existing POI exceeds 8.9 million minutes of use per month. *See* Sprint at 31. Because Sprint's proposal would either interfere with a CLEC's statutory right to determine POIs or require the CLEC to pay for the origination of traffic, it too is foreclosed by the Act. But even if the Commission had discretion to consider Sprint's proposal, it is both unnecessary and unreasonable. As explained above, CLECs already have incentives to – and do – establish additional POIs when there is sufficient demand in order to reduce unnecessary transport costs on their side of the POI. But there is no single threshold – whether at 8.9 million minutes per month or any other level – at which it is always efficient to establish an additional POI. Rather, the level at which it is efficient to establish additional POIs differs from area to area and from carrier to carrier, depending upon such factors as market entry strategy, geographic dispersion of customers, proportions of leased versus built networks, network topology, and network technology. *See* Talbott-Schell Decl. ¶¶ 39-40. Thus, Sprint's one-size-fits-all regulatory proposal would necessarily impose substantial error costs.[21]

Central Office Codes. The incumbents also ask the Commission to prohibit CLECs from offering central office codes ("NXX codes") to customers outside the specific geographic area associated with the NXX code. *See* SBC at 18; USTA at 32-24; Verizon at 4-8. In a remarkable fit of overstatement, the incumbents claim that CLECs' use of NXX codes in this manner – but not the incumbents' own functionally identical practices with which CLEC services compete – amounts to a "theft of services" that is "fraudulent" and unlawful. *See* Verizon at 5; *see also id.* at 7-8. As explained below, these claims are baseless.

"FX service" allows a customer to select a number assigned to an exchange other than the exchange that serves the customer's geographical location. Talbott-Schell Decl. ¶ 43. There is strong demand for this type of service for obvious reasons. Clearly, it is important for many types of businesses to be able to receive calls from customers in adjoining calling areas on a "local" basis. Traditional incumbent FX service involves the provision of local dial tone to a customer from a remote local switch; that is, a switch other than the one from which the customer would ordinarily receive local dial tone. *Id.* ¶ 47. When the incumbent's customer dials a number assigned to the customer's own legacy rate center and the incumbent routes that call to an FX customer who happens to be located in a different legacy rate center, the incumbent treats this call as a local call, not as a toll call. *Id.* That is, the end user that originated the call pays the incumbent's local charges for that call.

CLECs have developed their FX-type services based on their network architecture in order to compete with these existing ILEC "FX services." *See* Allegiance at 55-57; Focal at 57-58. Because these new entrant carriers have not deployed switches in every local calling area, they do not offer the type of remote dial tone service offered by ILECs. In particular, the fixed costs of switching are too large to justify such wide deployment of switches by nascent

(. . . continued)
[21] In this regard, Sprint has not provided a shred of empirical evidence, or even verified expert testimony, demonstrating that its proposed traffic threshold for the establishment of a new POI would be economically viable even for *most* entrants in *most* areas.

competitors with small market shares. Talbott-Schell Decl. ¶¶ 20-21. Thus, most CLECs enter by deploying a single centralized switch and then using efficient fiber optic transport facilities to "backhaul" traffic aggregated from a number of localities. *Id.* ¶ 20.[22]

This architecture permits CLECs to serve economically customers that may be located considerable distances away from their switches. *See id.* Thus, rather than seeking to mimic incumbent networks, architectures, and services, new entrant carriers instead compete by taking advantage of the ability to serve a large geographic area with fewer switches and more fiber optic transport. Although the services are provided differently due to the different ILEC and CLEC network architectures, a CLECs' FX-type service, just like an ILECs' FX service, assigns the customer a telephone number that has an NXX code associated with a geographic area different than the customer's actual location. *Id.* ¶ 49. A CLEC is able to offer FX-type service because the NPA-NXXs assigned to the CLEC reside in the same switch that serves the CLEC's FX-type customer. Thus, the CLEC does not require a private line arrangement to connect the customer to a remote switch as the ILECs do in a traditional FX arrangement. This common practice is not "fraud"– it is competition on the merits. Allegiance at 55-56.

Such CLEC services are particularly valuable to small businesses which "rely upon [FX-type service] to establish a market presence and compete effectively" and to "customers who subscribe to dial up internet access or to digital television recorder services." KMC at 6. *See also* Allegiance at 55-56 ("A CLEC's use of VNXX codes allows it to offer a service comparable to the ILECs' FX service and to provide a competitive alternative to those

[22] In contrast, ILEC networks were developed in an era in which there were technological limits on the ability to serve customers at great distance from central offices. Talbott-Schell Decl. ¶ 19. Also, ILECs have huge customer bases and, therefore, can economically deploy multiple switches even if those switches do not serve as large a geographic area as do CLEC switches.

businesses that find it desirable to obtain local numbers in several communities while maintaining a limited number of physical locations. It also benefits consumers in rural and sparsely populated areas by allowing them to reach a wider range of businesses and services without incurring toll charges"); Cbeyond at 13; CompTel at 26; Focal at 57-58. And it is precisely for these reasons that state commissions have concluded that "the discretion that CLECs exercise in designing their local calling scopes is a competitive innovation that enables them to provide valuable alternatives to an ILEC's traditional services." *Application of Ameritech Michigan to Revise its Reciprocal Compensation Rates and Rate Structure and to Exempt Foreign Exchange Service from Payment of Reciprocal Compensation,* Opinion and Order, Case No. U-12969, at 10-11 (Mich. PSC Jan. 23, 2001).

Prohibiting CLECs from continuing their current FX-type offerings would have a particularly severe impact on rural ISP and wireless customers. As AOL explains, eliminating the use of virtual NXX codes would likely require the majority of rural users to incur per minute toll charges for accessing the Internet. AOL at 7. "In effect, [the incumbents' proposed rule] change would impose access charges on those consumers who are least able to avail themselves of competitive choices and reverse a successful policy of widespread and affordable Internet access for all Americans." *Id.*

And as wireless carriers explain, there would be enormous disruption to wireless services and consumers absent the continued ability to offer customers local numbers regardless of physical location. "Because of the mobile nature of CMRS, there is necessarily little correlation between the virtual NXXs' geographic area and the mobile customer's actual location." AT&T

Wireless at 57. As such, it is not possible for a CMRS provider to guarantee that its customers are "within the geographic area of its assigned NXX." *Id.* at 58.[23]

Indeed, the ILECs make precisely these points in the filings of their CMRS affiliates. When Verizon is wearing its "wireless hat," it recognizes that "virtual" NXX codes are useful because, like CLECs, CMRS providers tend to have large geographic calling areas. Verizon Wireless at 32. Verizon correctly observes that allowing carriers to offer FX-type services to customers outside those areas reflects the needs of end users and the efficiency of permitting carriers to offer service "without requiring the . . . carrier to duplicate the [incumbent] landline network." *Id.* at 33. Thus, these comments make plain that incumbents are talking out of both sides of their mouth, arguing against use of virtual NXX codes when it threatens their incumbent monopolies and arguing for these codes in markets where they are forced to compete on the merits.

The incumbents complain that CLEC FX-type services cost incumbents money. That is hardly a gauge of competitive harm or unlawfulness. Nor is it true. CLEC FX-type services do not impose *any* additional costs on ILECs. *See* Verizon at 6, 8 n.15. The routing of traffic to a telephone number with a virtual NXX code is identical to all other traffic to such NXX code. *See* KMC at 6; CompTel at 26. The originating LEC only transports the call to the POI, not the entire way to the called party, regardless of whether the called party served by the CLEC is

[23] The ILECs' proposals would also effectively eliminate increasingly popular call forwarding services. These services allow a customer to have his assigned telephone number in one exchange forwarded to another number in a second exchange. Under the ILECs' proposals, which rate calls on the "physical location" of the calling and called parties, such call-forwarding would have to be rated as one call, but no mechanisms exist today to do this rating. *See* Talbott-Schell Decl. ¶¶ 57-58.

physically located in the incumbent's arbitrarily-determined local calling area.[24] Thus, the CLEC customer's location will not cause the originating incumbent's costs or functions to differ. *See* Allegiance at 59; Focal at 58. Nor does the payment of cost-based reciprocal compensation impose additional costs on incumbents. In the absence of competitive alternatives, the ILEC itself would have to terminate the same calls over its own network. In so doing, it would incur the forward-looking, economic costs of terminating the calls – the exact same rate that it must pay the CLEC under the Act's reciprocal compensation provisions.

Shorn of overheated rhetoric, the ILECs' argument thus amounts to no more than a plea to be held immune from the impact of competition. *See* Allegiance at 59 ("ILECs simply want to recover lost toll revenues, and if they cannot recover them from a customer they will gladly recover them from the CLEC instead"). SBC openly concedes this. SBC at 17 & n.27 (complaining that, while incumbent FX service requires the "called party . . . [to] pay[] for a business line" and that "these charges offset the toll charges that are not collected from the calling party," CLEC FX-type services "bypass applicable toll charges"). Congress in the 1996 Act did not promise the ILECs revenue neutrality; to the contrary, the primary purpose of the 1996 Act was to drive subsidies and monopoly rents out of existing incumbent services. Thus, to the extent CLEC FX-type services reduce demand for incumbents' FX services, this is the natural working of market forces and a reason to encourage – not to forbid – CLEC use of virtual NXX codes.

The incumbents certainly have no serious claim that CLEC FX-type services are unlawful unless CLECs are forced to pay the incumbent access charges for all calls delivered to

[24] To the extent that the ILECs are implicitly challenging the single POI requirement, that argument is addressed above. *See supra* 34-38.

customers located outside the incumbent's local calling area. Unable to cite any provision of the Communications Act to support their position, the ILECs instead argue that CLECs are "wast[ing]" numbering resources in violation of the Commission's telephone numbering regulations and that charging reciprocal compensation for the termination of calls to CLEC FX-type customers violates the Commission's *ISP Remand Order*. *See* Verizon at 8, 10. Both claims are baseless.

CLECs use NXX codes no differently than the way that ILECs use them. An incumbent FX customer is physically located in a different area than the NXX code it is assigned. *See* Cablevision Lightpath at 6; Focal at 57. Similarly, as discussed above, the CMRS affiliates of the ILECs frequently assign NXX codes to customers located in areas different than the location associated with the NXX code. The only real distinction between the use of NXX codes is the type of LEC using them.

The incumbents therefore must urge the Commission to create a rule that allows their use of NXX codes in this fashion because they utilize a switch located in the area to which the NXX code is assigned (although the FX customer itself resides outside that area), while forbidding any CLEC use of an NXX code to serve a local calling area in which it has not physically deployed a switch. *See* Verizon at 7-8.[25] Fundamental principles of competitive neutrality preclude this arbitrary and result-oriented distinction from being the standard for determining whether a carrier is entitled to an NXX code. As explained above, it is simply not economic for CLECs to replicate incumbent networks. *See also* Cbeyond at 13. Rather, it is generally more efficient for

[25] Verizon also defensively asserts that its use of virtual NXX codes can be justified from the fact that "[u]nlike CLEC" services, "ILEC FX services do not impose transport costs on other carriers." Verizon at 15 n.8. But that is no distinction. As explained above, CLEC FX-type services do not impose any additional costs on ILECs.

CLECs to serve larger geographic regions with each switch – regions that often cover several incumbent local calling areas. Thus, adopting Verizon's proposal to assign NXX codes only for those locations where a carrier has deployed a switch would preclude not only offering competitive FX offerings, but also offering any local service outside an area where a switch is located. *See* AOL at 7 (because "incumbent carriers are the only carriers with ubiquitous facilities," requiring "each CLEC serving [a customer to] have facilities within each the local calling area in order for end-users to be able to use a local NXX," would be "anticompetitive" and foreclose FX competition).

To be sure, numbering resources are "scarce." Verizon at 8. Competitive FX services, however, do not "waste" these resources in contravention of the Commission's rules. *Id.* To the contrary, all consumers benefit from allowing carriers to give consumers a number that corresponds to a different local calling area than where the consumer physically resides because this use of "virtual" NXX codes facilitates the ability of CLECs to offer consumers alternatives to incumbent FX services.[26]

Nor does the *ISP Remand Order* excuse the ILECs from paying reciprocal compensation on this traffic. *See* Cablevision Lightpath at 6. As the Commission recognized in this order, all

[26] Contrary to Verizon's claims (at 8-9) that the Commission's numbering administration rules currently ban use of virtual NXX codes, the Commission is currently considering this issue in connection with overall numbering optimization in CC Docket No. 99-200. As CompTel explains (at 28), the overall impact of virtual NXX codes on numbering optimization is complex. In many instances, virtual NXX codes actually improve numbering utilization. *Id. See also* KMC at 9-10. Further, it is important to consider any limitation on virtual NXX codes in connection with rate center consolidation and assignment of NXX codes in smaller blocks. CC Docket No. 99-200, and not this docket, is clearly the proceeding in which the Commission should make any decision as to whether or not it should modify its existing numbering rules to limit assignment of virtual NXX codes in order to prevent the exhaustion of numbers in some areas.

"telecommunications" traffic between LECs is subject to the reciprocal compensation provisions of the Act, 47 U.S.C. §§ 251(b)(5), 252(d)(2), whether the traffic is "local" or "non-local," *ISP Remand Order* ¶¶ 26, 34. Virtual NXX traffic is undeniably "telecommunications" within the meaning of the Act. "Telecommunications" is defined in the Act as "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information received." 47 U.S.C. § 153(43).

Although Congress in Section 251(g) of the Act temporarily "grandfathered" pre-existing federal compensation rules governing "exchange access" and "information access" traffic between, on the one hand, LECs which were in existence on February 8, 1996, and, on the other hand, IXCs or information service providers, there were no such rules with respect to virtual NXX traffic when the 1996 Act was passed, and thus, Section 251(g) cannot excuse the ILECs' payment of reciprocal compensation for this traffic. *See* Cablevision Lightpath at 7-8. And even if such pre-existing compensation rules had existed they would not be grandfathered by Section 251(g), because virtual NXX traffic is not "exchange access." "'[E]xchange access' means the offering of access to telephone exchange services or facilities for the purposes of the origination or termination of telephone toll services." 47 U.S.C. § 153(16). "Telephone toll service," in turn, is defined as "telephone service between stations in different exchange areas *for which there is made a separate charge not included in contracts with subscribers for exchange service.*" *Id.* § 153(48) (emphasis added). CLECs do not charge end users separately for virtual NXX service but instead include it as part of their basic local service offering. "Therefore, by definition, [virtual NXX traffic] is not a toll service and is not included within the exemption from reciprocal compensation." *Petition for Arbitration to Establish an Interconnection*

Agreement between TDS Metrocom, Inc. and Ameritech Michigan, Opinion and Order, Case No. U-12942, at 22 (Mich. PSC Sep. 7, 2001).[27]

This plain reading of the Act is confirmed by the Commission's interpretation of Section 251(g) in the *ISP Remand Order*. There, the Commission concluded that "exchange access" is a service "provided by LECs to . . . interexchange carriers." *ISP Remand Order*, Powell, Chairman, stmt., at 1. CLEC FX-type service, of course, is not provided to interexchange carriers but directly to end users and, for this reason too, cannot be considered exchange access.

Indeed, any other conclusion would fly in the face of the fact that virtual NXX traffic and exchange access traffic are handled in fundamentally different manners by telecommunications networks.

> Traffic routed to telephone numbers from virtual NXX codes are delivered directly from the originating LEC to the terminating LEC. Exchange access traffic is routed from the originating LEC to the IXC chosen by the calling party, which then routes the traffic to the terminating LEC.

KMC at 7-8. *See also* CompTel at 26 (explaining how "[t]raffic routed to telephone numbers from virtual NXX codes is identical to all other traffic that is subject to reciprocal compensation pursuant to Section 251").

Tellingly, the ILECs have treated calls to *their* FX customers as "local" for reciprocal compensation purposes as well. For example, Verizon still bills CLECs reciprocal compensation for calls to its FX numbers and is asking the Florida PSC to continue this practice. *See*

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[27] Of course, some CLEC FX-type service is provided to ISPs. But even under the *ISP Remand Order*, that fact could not excuse incumbents from paying reciprocal compensation for the termination of traffic to those ISPs. Rather, reciprocal compensation would have to be paid pursuant to the detailed framework established in paragraphs 77 to 88 of the *ISP Remand Order*. *See also* Allegiance at 53-54.

Allegiance at 56. It is too late in the day for the ILECs to complain when the shoe is on the other foot.[28]

In sum, it is clear that rather than compete on the merits, the ILECs are trying to use regulation to preserve their monopoly rents and to eliminate the competition from CLECs' FX-type services. The incumbents' arguments in this regard are particularly disingenuous given that they assign their FX customers NXX codes associated with local calling areas outside of where they physically reside and, in this very same proceeding, argue that their wireless affiliates should be able to offer their customers services utilizing virtual NXX codes. Most fundamentally, however, the ILECs' arguments are simply unlawful. Sections 251(b)(5) and 252(d)(2) unambiguously require that the ILECs pay reciprocal compensation when CLECs terminate traffic from incumbents' customers, regardless of the NXX to which a customer is assigned.

Transiting Traffic. As AT&T explained in its opening comments, transiting is plainly in the public interest. "Transiting," which occurs when a LEC transports traffic from one carrier's network to another carrier's network, is common among ILECs, CLECs, and CMRS providers. Transiting lowers barriers to entry because the two carriers avoid having to incur the costs of constructing the dedicated facilities necessary to link their networks directly. *See* AT&T, Ordover-Willig Decl. ¶ 87. Thus, transiting allows carriers which do not exchange significant amounts of traffic to interconnect efficiently with each other. *Id.* ¶¶ 86-88.

[28] At the same time, permitting ILECs to impose access charges on CLECs in connection with calls to customers of FX-type services would require a total – and expensive – reformulation for the rating and billing of intercarrier traffic. *See* Talbott-Schell Decl. ¶¶ 57-62. AT&T developed an estimate for these billing changes in Texas Docket No. 24015 and that record shows that AT&T's estimated one-time cost for development of systems would be in the nature of $3-$4 million, plus $0.5 million per month for additional maintenance and processing costs. *Id.*

In its comments, Sprint provides evidence (at 34) that several ILECs have refused to provide transiting, thereby requiring CLECs to interconnect with every ILEC, CLEC, and CMRS carrier in a LATA. The Commission should make clear that such denials violate the Act. As the Commission recognized in the *Local Competition Order*, transiting is mandated by Section 251(a)(1), which requires "indirect" interconnection. *See Local Competition Order* ¶ 997. It is also mandated by Section 251(c)(2)(B), which obligates ILECs to allow interconnection at any technically feasible point. By definition, interconnection at the tandem switch provides access to the full tandem switching functionality – including access to subtending end offices, even if not owned by the tandem provider. In other words, an ILEC must provide access to any office that subtends one of its tandems even if that end office is operated by another LEC.

Before state commissions, some ILECs have advanced tandem exhaustion as a reason to prohibit transiting traffic. *See Petition of AT&T Communications of Virginia Inc.,* CC Docket No. 00-251, Direct Testimony of Don Albert & Peter D'Amico, at 34-36 (July 31, 2001). To satisfy a claim of technical infeasibility, an ILEC "must prove to the state commission, with clear and convincing evidence, that specific and significant adverse impacts would result from the requested interconnection or access." *Local Competition Order* ¶ 203. No such showing could be made with respect to transiting traffic – incumbents can avoid tandem exhaustion through proper forecasting and, where necessary, deploying additional tandem switching capacity. And, to the extent that any tandem augmentation is, indeed, required by transiting traffic, the incumbent is appropriately compensated by cost-based rates. In fact, however, compared to the total volume of traffic which passes through incumbent access tandems, the volume of competitive local exchange transit traffic is relatively small. Also, ILECs do not limit the volumes of IXC traffic through their tandems.

Tandem Rate Symmetry. The commenters that addressed tandem rate summetry agree with AT&T that the Commission should retain its existing rule, which allows CLECs to collect the ILECs' tandem rate when using a single-layer network that serves a comparable geographic area as an ILEC tandem. *See* Cablevision Lightpath at 8; Time Warner at 31. The tandem rate proxy established by Rule 51.711 is economically sound because it recognizes that, in modern networks, transport is substitutable for switching. And no commenter has presented a better proxy for the costs CLECs incur when terminating traffic.

Further, as AT&T explained in its comments, the symmetry rule is required by competitive neutrality. Allowing ILECs to earn much higher reciprocal compensation on traffic that they terminate than do CLECs, which provide the exact same service in the exact same area, would tilt the competitive playing field sharply in favor of ILECs and require CLECs to subsidize their competitors. That would be wrong-headed under any circumstances, but it is particularly so here, in light of the nascent nature of the CLEC industry coupled with the enormous advantages that ILECs already enjoy.

The tandem symmetry rule has two additional benefits. First, "symmetrical compensation rates are . . . administratively easier to derive and manage than asymmetrical rates based on the costs of each of the respective carriers." Time Warner at 30 (quoting *Local Competition Order* ¶ 1088). Second, "the symmetry presumption . . . diminishes somewhat the ILECs' ability to game the regulatory process to set reciprocal compensation to their advantage. If the ILECs convince regulators to set reciprocal compensation rates too high, then competitors will target large net terminators of traffic, and if ILECs convince regulators to set reciprocal compensation rates too low, the competitors will target net originators of traffic." *Id.* at 31. As such, the Commission should reject the ILECs' unprincipled challenge to the tandem symmetry rule, just as it should reject the ILECs' other attempts to use this proceeding to rid themselves of the Commission's pro-competitive rules.

CONCLUSION

In conclusion, the Commission should: (a) adopt a truly unified intercarrier compensation scheme with termination and transport rates based on forward-looking, economic costs; (b) reaffirm that competitive carriers should determine the point of interconnection between their networks and ILEC networks; (c) make clear that the regulatory treatment of a call is determined by the NPA-NXX code of the calling and called numbers and not the physical locations of the calling and called parties; (d) reaffirm the widespread practice of "transiting" in which CLECs indirectly interconnect with other CLECs, CMRS carriers, and independent telephone companies by paying ILECs to deliver their "transiting" traffic to such carriers; and (e) reaffirm the "tandem symmetry" rule which permits a competitive carrier to charge the "tandem" switching rate when it terminates calls from a switch in a "single-layer" switching architecture that serves a geographic area comparable to a tandem switch in the incumbent's "two-layer" switching architecture.

Respectfully submitted,

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November 5, 2001

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CERTIFICATE OF SERVICE

I hereby certify that on this 5^{th} day of November, 2001, I caused true and correct copies of the forgoing Reply Comments of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: November 5, 2001
Washington, D.C.

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Patricia A. Bunyasi